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Dear Ms Flores,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on EFRAG's, Autorité des Normes Comptables (ANC)'s and Financial Reporting Council (FRC)'s Discussion Paper (DP) "Towards a Disclosure Framework for the Notes".

Principal authors of this comment letter were Max Eibensteiner, Erich Kandler, Christian Groß, and Alfred Wagenhofer.

**GENERAL REMARKS**

We generally consider EFRAG's, ANC's and FRC's DP, which tries to systematically address the standard setting for notes information, to be a valuable contribution to further improve international financial reporting. However, we think that the current approach is not clear-cut enough, as the DP – even though intended to put emphasis on standard setting – is often (e.g., in the deliberations on materiality) not clearly centred towards its target audience (i.e., standard setters). We take the view that the suggestions to newly organise the notes could be modified so that a "highlight"-section, which would be linked to vital points (as e.g. emphasised in analyst presentations), introduces users to the notes of each one company and points to entity-specific idiosyncrasies. Additionally, a section containing information about the entity as a whole should be included into the notes. We also feel that the communication principles set out in the DP should not be part of a disclosure framework, as the average user's utilisation of the notes does not reveal a demand to reconsider well-established practices in this area.

## SPECIFIC REMARKS

**<u>Question 1.1</u> – The Discussion Paper sets out a number of key principles that should underpin a Disclosure Framework.**

**Do you agree with these key principles? If not, what alternative principles would you propose?**

Even though most of the key principles listed on page two and three of the discussion paper are understandable, we still think that the approach that has been taken in identifying and organising the key principles could have been clearer. While some of the principles refer to standard setters (or, more specifically spoken, the IASB) others, such as item 10 and 12, also refer to prepares and auditors. Moreover, principle 13 appears to be quite outside the scope of standard setting for general purpose financial statements and should be left to investor relations/public relations of preparers. Additionally, principle 14 is more similar to a political statement by preparers, auditors and regulators rather than a key principle and could therefore be dismissed.

Additionally, we note that even though the issue of notes and related disclosure frameworks is of broader global interest, EFRAG is implicitly referring to the specific situation of the IASB promulgating IFRS without mentioning this focus. Hence, we would either suggest to explicitly limit the discussion paper to the IASB's standard setting process or to be more general in its approach.

Key principles for standard setters mandating disclosures can also be found on p. 38 of the DP. Those principles seem agreeable. We feel that principle f. on page 38, which states that "disclosure should not be used to compensate for inadequacies in recognition, measurement and presentation requirements", challenges some disclosures currently in place in IFRS (or soon to be in place, respectively). IFRS 13, for example, requires disclosures of third level fair value information (thus, fair value information related to unobservable inputs). By doing so, potential weaknesses in measurement are clearly compensated with disclosures. A similar example can be found by looking at IAS 37's procedures related to the accounting for contingencies. Here, recognition is prohibited in IAS 37.27 and in 37.31. Conditional on the probability of occurrence, however, disclosures may be necessary. In our opinion, this principle and those examples are challenging not only some current disclosures but also aspects of the recognition concept.

**<u>Question 1.2</u> – This Discussion Paper suggests that there are two main areas for consideration to improve the quality of disclosures:**

**a. avoiding disclosure overload, which may be caused both by excessive requirements in the standards, and by ineffective application of materiality in the financial statements;**

**b. enhancing how disclosures are organised and communicated in the financial statements, to make them easier to understand and compare.**

**Do you agree that these are the two main areas for improvements?**

Generally, we agree. We would furthermore suggest that both those areas could be interrelated insofar as the understanding of financial reports (mentioned in b.) is likely to be enhanced if immaterial disclosures are avoided (a.) and other disclosures are adequately structured (again b.). Despite our general agreement on the areas of improvement, we still want to report the following two observations:

- ad a.: We want to emphasise that the difference between information overload and disclosure overload must not be mixed up. Additional disclosures that do not increase the relevance of the notes for users are to be avoided, whereas additional disclosures that increase the informational value of the financial statements are valuable.

- ad b.: As the vast majority of users will read the notes only selectively, we feel that the order of information is more important for other parts of the financial statements than for the notes.

**<u>Question 2.1</u> – In chapter 2 a definition of the purpose of the notes is proposed to assist in deciding what financial information should be required in the notes.**

**Do you think that there is a need to define the purpose of the notes? If not, please provide your reasoning.**

In our opinion there are two differing views relevant to answering this question: On the one hand, a set out focus of the notes is important, as they can become extensive and therefore burdensome for preparers otherwise. On the other hand, focusing on users' rather than preparers' needs, the notes should remain a repository of information that is not conveyed through other financial statements. A definition should, in our opinion, integrate both of these aspects.

**<u>Question 2.2</u> – Is the proposed definition of the purpose of the notes helpful in identifying relevant information that should be included in the notes? If not, how would you suggest it should be amended?**

Generally, we found the definition useful. We also found areas for improving the exact wording of the definition:

- The definition should not only focus on specific "…items presented in the primary financial statements…", but also on the fair presentation that the financial statements as a whole should convey. In this sense, information about the going concern assumption (which is mentioned on p. 28 of the DP) is important, as it is a requirement for the measurement basis used.

- "Reporting period" seems to be a better term than "reporting date", as (1) a focus on past transactions requires a link to the whole reporting period and (2) important incidents during the reporting period that concluded before the reporting date should still be mentioned in the notes.

Emphasising the paragraphs of the DP explaining and clarifying the proposed definition, we think that the focus on past transactions could be appropriate to increase the reliability of notes information. However, the sequence "…information about the future that is unrelated to those past transactions and other events, is not provided in the notes…" suggests that information about the future which is "related" to past transactions has to be disclosed. Basically, this could in most cases lead to similar requirements as today, e.g. providing information about "future cash flows" generated by recognized assets. We think that the focus on past transactions could better be addressed by applying the terminology already used in IAS 10 (e.g., IAS 10.3 or IAS 10.19).

**<u>Question 3.1</u> – In chapter 3, it is proposed to identify specific users' needs that the notes should fulfil. Those users' needs are drawn from the Conceptual Framework. It is also suggested that a Disclosure Framework should include indicators to assist the standard setters to decide when additional information is required to fulfil those users' needs.**

a. **Is the description of the approach clear enough to be understandable? If not, what points are unclear?**

b. **If you do not support this approach, what alternative would you support and why?**

c. **Do you think that a category on "information about the reporting entity as a whole" should be included? If so, why?**

ad a) Yes. Basically, a structured approach for setting up disclosure requirements helps standard setters to increase the informational quality of the notes. However, dependent on the issue under consideration, different weights will have to be assigned to the different aspects of the presented approach (i.e., no "one size fits all" approach is likely to work under all circumstances). Anyhow, the proposed structure – as general as it is – could be a suitable starting point for sound deliberations on mandatory disclosures.

ad b) Overall, we believe that the new disclosure framework should primarily be driven towards communicating the most relevant information. This does not need to substantially limit information compared to what is currently required. However, we propose an entity-specific "highlight" (i.e., "executive summary") section, which introduces users to the notes of any one company. This section would indicate idiosyncratic matters that specific emphasis should be put on when analysing financial statements in combination with the notes. This highlight-section could for instance be aligned with those aspects of the notes often stressed in analyst or investor relations presentations.

ad c) Information on the reporting entity as a whole should be included as a category of the notes, as they are essential to understanding financial statements. Moreover, uncertainties about the going concern assumption as well as information about the legal structure of an entity could be deemed useful (e.g., information on liability constraints). However, we feel that there is no need for more prescriptive requirements relative to other categories mentioned.

The logic of including the entity-wide perspective is that groups of assets may require information for users to better understand them. The reporting entity can, in this sense, be seen as the one asset at the highest aggregation level.

Even though we would generally agree to include an entity-wide perspective into the notes framework, we still acknowledge that the notes are just one potential place to communicate such information. Usually, this kind of information is included in most company reports, however often not within the narrow borders of the (IFRS) financial statements (but rather in the Management Commentary or in some specific section addressing strategic issues). Thus, we think that users already have sources to acquire entity-level information and it is at least questionable if a shift into the notes is necessary.

**<u>Question 3.2</u> – Are the proposed users' needs and indicators in chapter 3 helpful to identify relevant information? If not, how would you suggest amending them, or what other basis would you suggest to identify relevant information to be included in the notes?**

In the current form, the general nature of the identified user needs will make it difficult for standard setters to directly consider those needs when setting disclosure requirements (even if the examples in the Appendix often seem quite compelling). The FASB DP on a disclosure framework makes assumptions on the average user knowledge and uses it as the benchmark against which to assess relevance. A similar approach is brought forward on p. 33 of this DP: "…assuming that users have a reasonable knowledge of business and familiarity with accounting standards." As thoughts about user knowledge seem to be fundamental for the topic under consideration, this point should be given more emphasis – perhaps also much earlier in the text.

In addition to the first point mentioned, we basically support the avoidance of disclosures based on unverifiable expectations. As the term "future cash flows" is used extensively when addressing users' needs in the DP, we would opt for some approach that reduces this emphasis.

**<u>Question 3.3</u> – Do you agree with the way how risk and stewardship are addressed in the Discussion Paper? If not, what are your views about how risk and stewardship information should be provided in the notes?**

The discussion of risk disclosures (on p. 31 of the DP) is not consistent with users' needs: Based on the definition, the DP uses the reported items granularity. However, risks do not add up generally, but may diversify within the entity. So, reporting risks of individual items is likely to overstate the risk of groups of items and particularly the entity itself. Based on this argument, we feel that it is more appropriate to report risk disclosures jointly (as discussed on p. 32 of the DP). We would support this line of thought, as a higher level of aggregation allows including a risk-specific diversification perspective into the notes. A similar argument could also be brought up to justify the need for entity-wide disclosures (question 3.1 c.): Usually, individual asset values also do not simply add up to the value of a group of assets, as synergies have to be considered.

As far as the stewardship issue is concerned, we think that no explicit disclosure requirement is needed. This is primarily linked to the aim of disclosures (and, therefore, a disclosure framework): Even though financial statements are often considered to fulfil a stewardship- and a decision-usefulness-objective, disclosures (and prioritisation of the two objectives as well) are in most of the cases linked to the latter – especially as far as international accounting standards are concerned.

**Question 3.4 – Standard setters frequently mandate detailed disclosure requirements in each standard. In chapter 3, it is suggested that the way in which disclosures are established influences behaviours, and alternative approaches are discussed.**

**Do you think that standard setters should change their practice of mandating detailed disclosure requirements in each standard? If so, which of the alternative approaches discussed do you think will be the most effective in improving the quality of information in the notes?**

The first question here can be disentangled into two more basic questions: Should standard setters change their practice of mandating…

1. … *detailed* disclosures?
2. … disclosure requirements in *each standard*?

Considering the first question on the level of detail, current standard setting practices often lead to a burdensome disclosure overload for preparers. Focusing on this point, less detailed (and perhaps more integrated) disclosures seem to be preferable (see also our answer to question 1.2). Emphasising the second aspect of the question, it is practicable to include disclosure requirements in each standard. We think, however, that there should be high-level principles for disclosures. The disclosure requirements in each standard should then be interpreted in the light of these principles. Another way to organise a disclosure framework could be to detach formal from contentwise requirements. The formal requirements – ideally depicted in some general section – could frame the way disclosures are generally presented (e.g., standard table formats), while the contentual requirements could then be outlined in each standard separately.

A further alternative approach could be linked to industry-specific information (even if IFRS try to avoid industry standards to date): More attention could then be devoted to business- or branch-specific disclosures as they would result in enhanced comparability between entities with similar business characteristics. Such an approach would consider that in many cases users are more interested in common characteristics within one industry than in the common features of all entities.

**<u>Question 3.5</u> – Some standard setters have established, or have proposed establishing, differential reporting regimes on the basis that a 'one size fits all' approach to disclosures is not appropriate. They consider that reporting requirements should be more proportionate, based on various characteristics such as entity size, or whether they relate to interim or annual financial statements?**

**Do you think that establishing alternative disclosure requirements is appropriate?**

We support differential requirements. Besides size, other characteristics may be used to differentiate disclosure requirements between different (groups of) entities (e.g., ownership structure, equity or debt capital issued or trading volume). However, as companies can always voluntarily disclose additional information they consider to be relevant, the question remains if differential reporting should be part of a disclosure framework. A related question arising in this context seems to be whether a disclosure framework would (have to) restrict voluntary disclosures to a certain degree.

**<u>Question 4.1</u> – Chapter 4 discusses the application of materiality to disclosures. Currently, IFRS state that an entity does not need to disclose information that is not material.**

**Do you think that a Disclosure Framework should reinforce the application of materiality, for instance with a statement that states that immaterial information could reduce the understandability and relevance of disclosures?**

Yes, reinforcement of the application of materiality seems useful, although it would be difficult to enforce. We also think that there should be no difference between materiality defined for the purpose of setting up the primary financial statements and the one defined for disclosure requirements. Hence, we do not agree with the implicit suggestion in the DP on pp. 26 f., when (dis-)aggregation is discussed. From this discussion, it can be inferred that materiality in the notes is interpreted differently (i.e., less stringently) than in the financial statements.

**<u>Question 4.2</u> – Chapter 4 also includes proposed guidance to assist in the application of materiality.**

**Do you think that a Disclosure Framework should include guidance for applying materiality? If you disagree, please provide your reasoning.**

Yes, as materiality is a key issue in determining the amount and extent of disclosures, guidance for application should be provided. Such guidance should be provided on the standard setters' as well as on the preparers' level. However, although it would be helpful to have *specific* guidelines related to materiality issues, we doubt that a feasible solution can be achieved. As a matter of fact, materiality highly depends on entity-specific circumstances (entity size, number of transactions, relative size of transactions, balance sheet structure, industry the company operates in etc.). Hence, in order to find a common ground, it will be hard to come up with something other than a fairly general guidance.

**Question 4.3 – Is the description of the approach clear enough to be useful to improving the application of materiality? If not, what points are unclear or what alternatives would you suggest?**

The DP proposes a distinction between type 1 and type 2 items (p. 54 f). For type 1 items the DP proposes that entities specify if they did not recognize those items for reasons of unreliable measurement or because of immateriality. Materiality is assumed if an unrecognized item affects the trend or the transaction is recurring (relative to non-recurring). This discussion in the DP appears to be highly theoretical, and the distinctions seem somewhat arbitrary. For example, we see recurrence as an important characteristic for any earnings item and for any unrecognized item. Therefore we do not agree with the DP's approach that recurrence only plays a role for unrecognized items. Also, the question remains, why materiality appears in the second distinction separately, which appears to be circular.

This section, however, is not only highly theoretical but also reveals two major problems of the DP: Firstly, even though the disclosure framework is primarily aimed at standard setters, the border line to preparers can't be as clear-cut as it is probably intended to be. E.g., is the "guidance on the assessment of materiality" only meant to be used by standard setters in the process of defining disclosure requirements or also by preparers when setting-up the notes for a specific entity? The second issue is related to materiality itself: the indicators provided in the DP only outline that a materiality issue might exist in case of specific circumstances but it is silent on how materiality should be assessed.

Seen solely from the standard setting perspective, the materiality indicators are less helpful as they don't give an ultimate answer to the question whether an item is material or not. Accordingly, standard setting for additional disclosures without a suitable consideration of materiality indicators will most likely remain a frequent choice.

**Question 5.1 – Chapter 5 includes proposals for improving the way disclosures are communicated and organised.**

**Would the proposed communication principles improve the effectiveness of disclosures in the notes? What other possibilities should be considered?**

Although the basic communication principles set out in the DP should be self-evident, having them summarised in written form could be useful for standard setters to reassess the existing disclosure structure and the form of the notes considering these requirements. We feel, however, that the structure of the communicated information (as well as potential communication channels) shouldn't be part of a disclosure framework. Even though we consider integrated reporting to be an important development for financial reporting as a whole, the average user's utilisation of the notes – i.e., focusing on specific excerpts rather than reading them exhaustively – suggests that a framework for the notes is not the place to primarily address this issue. The highlight-section we proposed to introduce every one company's notes (see our answer to question 3.1 b) could be a way to add structure to the notes without over-emphasising the integration of notes disclosures.

Another possibility for a principle would be that more material items could be given more space (or emphasis) in the disclosures, so that space is (or highlighted sections are) an indicator of the relevance the entity ascribes to the information. This is related to prioritising (p. 63), but introduces space usage (or accentuation) rather than relative place to indicate the importance of disclosures.

**<u>Question 5.2</u> – Do any of the suggested methods of organising the notes improve the effectiveness of disclosures? Are there different ways to organise the disclosures that you would support?**

We would agree that some of the methods discussed could improve the effectiveness of disclosures. However, the current communication approach (as defined in IAS 1.114) is the most intuitive one, common practice among preparers and well known and understood by users. Thus, there is no basic need to change this approach and therefore this part of the disclosure framework project should not be emphasised on a very broad basis.

Additionally, the discussion of technology, in particular XBRL (p. 64), is overly positive. We believe that developments such as XBRL will have effects on disclosures that run counter those desired. For example, the XBRL taxonomy has the potential to create a checklist of "standard" disclosures, and entities are likely not to miss out on assigning all available tags to items. Doing so, materiality will be neglected. Flexibility, as is implicit in XBRL, is unlikely to be used, as it would work against standardisation and as the majority of users will not search for individual tags. A potential effect of XBRL could also be that the order of presenting disclosures will not matter anymore. Thus, using this technology for the communication of notes information, prioritisation can't be indicated by the relative place of items.

**<u>Question 6.1</u> – Are there any other issues that you think need to be addressed to improve the quality of information reported in the notes to the financial statements? Please explain how you think these issues should be addressed and by whom.**

We think that the most relevant issues have already been addressed in our preceding answers.

Kind regards,

Romuald Bertl

Chairman